

SALES AND USE TAX REVIEW COMMISSION

RECOMMENDATION PURSUANT TO P.L. 1999, C. 416

BILL NUMBER: A-3329

**DATE OF
INTRODUCTION:** 3/22/01

SPONSOR: Assemblyman Lefevre

**DATE OF
RECOMMENDATION:** 5/30/01

IDENTICAL BILL: S-2291

COMMITTEE: Assembly Commerce, Tourism, Gaming and Military and
Veterans Affairs

DESCRIPTION:

This bill would allow certified vendors in certain downtown business districts to collect 3% sales tax.

ANALYSIS:

The number of communities authorized to charge 3% sales tax has proliferated substantially over the past several years.

This bill would result in many of the same undesirable conditions already caused by the urban enterprise zone reduced sales tax rate benefit program and the Salem County reduced sales tax rate. Even assuming that the reduced sales tax rate benefit might attract new business to the “downtown business districts” favored under the terms of the bill, the piecemeal creation of such specially favored districts will simply shift economic growth from one neighborhood to another; if a qualified district does experience an increase in healthy economic activity, its good fortune would be at the expense of neighboring districts, which arguably would be placed at a competitive disadvantage in attracting new vendors or customers willing to engage in transactions at the full 6% rate.

A special reduced sales tax rate for sales within certain portions of New Jersey will also create a potential legal problem, if the full compensating use tax rate is applied when taxable tangible personal property purchased out-of-state or from non-New Jersey mail order vendors is “used” in an urban heritage district. By the terms of the bill, the one-half reduced sales tax rate would apply only to sales originating from and delivered from a business located in a downtown business district. But giving full effect to this physical-location requirement could result in a violation of the Commerce Clause of the United States Constitution. The State cannot lawfully subject a sale of merchandise taking place within New Jersey to only 3% sales tax, while imposing a use tax rate of 6% on a comparable item that was purchased from an out-of-New Jersey source.

In Associated Industries of Missouri v. Lohman, 511 U.S. 641, 114 S. Ct. 1815, 128 L. Ed. 2d 639 (1994), the United States Supreme Court held that Missouri’s sales and use tax scheme violated the Commerce Clause in any localities where the state use tax exceeded the local sales tax. The tax scheme at issue in the Associated Industries case contained several layers. The statutes and constitution of Missouri imposed various state sales taxes, and, in addition, state legislation authorized political subdivisions to enact their own local sales taxes. Many localities did so. Thus, in some localities, the combined use tax was lower than the combined sales tax rate, while in others, the use tax was higher. The Court considered it irrelevant that the tax scheme lacked any discriminatory intent. Instead, it concluded that the test for validity of a compensatory use tax required mathematical precision: in order to be permissible under the Commerce Clause, any use tax rate imposed on an item purchased out-of-state had to be no more than the sales tax rate imposed on a similar transaction within the state. It therefore held that the effect of Missouri’s tax scheme impermissibly discriminated against interstate commerce in any locality where the sales tax rate was less than the use tax rate.

In light of the Associated Industries ruling, it appears that New Jersey statutes creating a partial exemption for certain retail sales only if they take place within a certain district (i.e. only intrastate sales) would similarly not survive constitution scrutiny. In order to avoid constitutional challenges, New Jersey has had to apply the reduced (3%) rate administratively both to sales actually taking place in UEZ or Salem County and satisfying the other statutory criteria for the partial exemption and to any out-of-state purchases, when the first use of the goods takes place in Salem County or a UEZ. If this bill is enacted, it will need to do the same thing for use tax in the traditional downtown business districts. Only in that way could the partial exemption not discriminate against interstate commerce, since both sales tax and use tax would be 3%. But, while this solution would at least probably shield the State from constitutional attacks, it would result in substantial losses in tax revenue and would fail to advance the purpose for which the traditional downtown business district partial exemption is intended.

Therefore, the policy question that needs to be addressed is whether it is in the best interest of the State and the State's business community to continue to approve more of these special 3% sales tax districts. It appears that a saturation point may have been reached. Also, by adding more districts, the advantage enjoyed by the existing districts is likely to be diminished.

Also, the granting of the 3% sales tax benefit is not as simple as it appears. The 3% sales tax benefit does not apply to all sales of tangible personal property. It would not apply to sales of motor vehicles, alcoholic beverages, cigarettes, catalog or mail order sales, sales of services, prepared food, meals and beverages, telecommunications, and charges for occupancy, admissions and amusements. Those sales would remain taxable at 6%. Consequently, it will be necessary to design a special sales tax return for businesses in traditional downtown business districts and it would also be necessary to somehow indoctrinate each business as to the kinds of transactions that are eligible for the 3% rate and those that are not. Unfortunately, the Division of Taxation would have to use its limited resources to accomplish this.

RECOMMENDATION:

The Sales and Use Tax Review Commission does not recommend this bill for enactment.

COMMISSION MEMBERS FOR PROPOSAL:

COMMISSION MEMBERS AGAINST PROPOSAL: 5

COMMISSION MEMBERS ABSTAINING:

COMMISSION MEETING DATE: May 30, 2001

NC:sp